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Depreciation and obsolescence in hotels; Report of the Depreciation Committee of the American Hotel Association of the United States and Canada; Hotel depreciation studies

E. C. Eppley

Paul Simon

American Hotel Association of the United States and Canada. Depreciation Committee

DEPRECIATION AND OBSOLESCENCE IN HOTELS

PART I

Report of the Depreciation Committee
of The American Hotel Association
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PART I

REPORT OF THE DEPRECIATION COMMITTEE

E. C. EPPLEY, Chairman

THE study of depreciation and obsolescence of hotels was undertaken by the American Hotel Association of the United States and Canada upon the request of the Commissioner of Internal Revenue who authorized the Bureau of Internal Revenue to co-operate with "nationally representative organizations" of industry.

Similar studies have been conducted by the National Association of Building Owners and Managers, the Pulp and Paper industry, and others, and the movement is endorsed and supported by the Department of Manufacture of the Chamber of Commerce of the United States.

Purpose of Study

I beg to quote from a pamphlet of the Bureau of Internal Revenue as follows:

"The prime objective of the present studies is greater equity in tax collection, but an important secondary consideration will be the saving of substantial amounts both to the government and to the taxpayer through the elimination of avoidable disputes. It is obviously impossible for several thousand income tax auditors and revenue agents to exercise similar judgment in the review of tax returns, particularly as the auditor or revenue agent in many instances has not had the advantage of experience in the industry for which he is auditing or examining a return. The publication of average rates of depreciation, by items of plant and equipment, by industries, is essential to the elimination of personal inexperience and error, either by representatives of the taxpayer or of the Government."

In our particular industry I can see a number of additional advantages which will accrue to us from this study, especially in that it will supply information to a great many members of our industry who make insufficient provision for depreciation. The operators who do not take into consideration this important element of cost until it is too late, are undesirable competitors, not only because eventually they ruin themselves and harass others by selling below cost, but also because quite frequently they are the unintentional cause of over-construction by appearing to make profits, while they are actually losing money.

In the course of our study we have found here and there, in our contact with hotel operators, an expression of fear that by establishing an average standard rate of depreciation it might be difficult to obtain a higher or lower allowance in such cases where particular circumstances warrant a deviation from the established standard.

To eliminate such fear I wish to quote from the above mentioned bulletin as follows:

> **"Adaptation of Conclusions to Variable Conditions of Use—** The purpose of the Bureau of Internal Revenue is to determine flexible standards of depreciation, not to establish rates from which no deviation will be permitted. Any inflexible rule will work some injustice, as there will be numerous exceptions to al-

most any rule of that nature. The plan is to determine average rates of depreciation which will be accepted by the Commissioner of Internal Revenue without substantiation and without adjustment, and to require substantiation in proportion to the departure of the rates used from such average rates. No reasonable rate of depreciation will be prohibited, and within a certain range of the average rates little substantiation will be required."

and also the following from the same pamphlet:

"The individual taxpayer will always have the opportunity to depart from the average rates when unusual conditions apply to his specific case."

Requirements by the Bureau of Internal Revenue

For the consideration of the suggestion of the hotel industry pertaining to depreciation the bureau requires only the following:

(1) A statement of the useful lives of the depreciable assets of an industry by items or by classes of similar items, preferably departmentalized according to the different processes employed, services rendered, or products made by the industry. Such a schedule affords the only possible basis of comparison between the diverse methods for depreciation accounting, and gives the fundamental information required for the determination of essentially similar depreciation rates irrespective of the method employed.

(2) A statement of the principles and methods of depreciation accounting best suited to the business conditions of the industry to which the results of the study will apply.

Activities of Your Committee on Depreciation

Questionnaires and letters have been sent to all hotels who through their affiliation with state, district or provincial hotel associations are members of the American Hotel Association, approximately seven thousand in all.

The same questionnaires have also been sent to the hotel accountant's associations now in existence.

We have received answers pertaining to 2,232 hotels, which, considering the technicality of the subject and the usual reluctance of our craft in answering questionnaires, was considered quite encouraging and gave us an additional impetus in our work because it proved to us that the study was considered an important one by our confreres. In was especially gratifying that the answers came, not only from the large establishments, but that the operators of medium sized and small hotels took an active interest.

Many of the answers were accompanied by letters, a great many of which contained an exceptionally intelligent expression of the writer's experience and opinion.

These expressions were given very careful consideration and have been given effect to, as far as it was feasible, in arriving at what we propose to submit to this body and in due course to the Treasury Department, if so authorized.

It was practically impossible to answer these letters, as the number was too great, but I wish here to thank all those who have given us their support and I wish to apologize for my inability to personally acknowledge the receipt of these letters.

I also beg permission to express especially my appreciation of the advice and information received from the following gentlemen:

Arthur L. Race, Copley-Plaza, Boston.
A. Allerton, Canadian Pacific Hotels.
F. D. Ray, Hotel Bossert, Brooklyn, N. Y.
L. C. Prior, The Lennox, Boston.
G. T. Weber, Chittenden, Columbus.
E. C. Green, Buffalo Statler.
C. B. Stoner, Statler Organization.
A. C. C. Gamer, Hotel Olympus, Tacoma, Wash.
Tracy Drake, Blackstone, Chicago.
John Willy, Hotel Monthly, Chicago.
Arthur L. Roberts, Roberts Hotel System.
C. A. Moore, H. L. Stevens and Company, New York and Chicago.
Wm. J. Quinn, Monticello, Norfolk, Va.
D. R. Lane, Blackhawk Hotel, Davenport, Ia.
G. S. Nollen, Banker's Life Co., Des Moines, Ia.
Edward Boyce, The Portland, Portland, Oregon.

The answers to the questionnaires were turned over to the firm of Horwath & Horwath, who made a compilation and thorough analysis. As a result, a pamphlet was prepared by Mr. Paul Simon, one of the members of the above firm, copies of which will be distributed to you for your information.

A preliminary conference was held in Chicago with Mr. J. A. Grimes, Valuation Engineer of the Bureau of Internal Revenue, some time in June, and Mr. Simon and I went to Washington on September 14th for a conference with officials of the Treasury Department.

A final meeting of the committee on depreciation was held here in Denver yesterday. As the outcome of our labors I submit the following resolution:

Resolution

"Be it resolved, that in the consensus of opinion of the American Hotel Association of the United States and Canada, in annual convention assembled, the rates of depreciation and obsolescence, as listed in the appendix hereto, correctly express the average life of the assets in hotels to which they refer;

and be it further resolved, that the Committee on Depreciation be authorized to suggest to the Bureau of Internal Revenue of the United States Treasury Department that they accept these rates as a fair average to be used by the industry in connection with the preparation of federal income tax returns."

We make this recommendation notwithstanding the fact that our conclusions may not be 100% correct.

Reserves for depreciation, of course, cannot be more than an estimate of the life of the assets to which they pertain and life is uncertain.

However, our conference in Washington brought out that the department officials fully realize this fact and also fully realize that perfection will never be achieved. Therefore, their agreement with the hotel industry will be flexible and may be changed at any future date whenever it is found to be in need of revision or improvement.

Respectfully submitted,

E. C. EPPLEY,
Chairman.

APPENDIX

These rates and the accounting procedure to be followed, pending their adoption, are briefly outlined as follows:

Buildings—	Average Life, Years	Annual Rate of Depreciation
Fireproof and semi-fireproof	30	3⅓%
Frame	25 to 30	3⅓ to 4%
Furniture, Fixtures and Equipment— *Unit Rates:*		
Guest Room Furniture	12	8.33%
Springs, Mattresses, Pillows	9	11.11%
Blankets	6	16.67%
Lobby Furniture	8	12.50%
Portable Lighting Fixtures	8	12.50%
Carpets and Rugs	6	16.67%
Curtains, Draperies, Scarfs	5	20.00%
Dining Room Furniture	12	8.33%
Kitchen Equipment	10	10.00%
Refrigeration System	11	9.09%
Office Furniture	14	7.14%
Office Machinery	6	16.67%
Laundry Machinery	10	10.00%
Window Shades and Screens	5	20.00%
Sundry Equipment	10	10.00%
Furniture, Fixtures and Equipment: Composite Rate based on above rates in relation to comparative value of each class to value of total equipment.	..	11.98%
Rounded to Average Life 8⅓ Years	..	12.00%

China, Glass, Silver and Linen:

On original investment—

China: 5% per year to 75% of original value at end of 5th year.

Glassware: No depreciation.

Silver: 10% per year to 50% at end of 5th year.

Linen: 16⅔% per year to 50% at end of 3rd year.

All replacements to be charged to current expense by means of a reserve account for replacements. Periodical inventories of this equipment are to be taken to determine the actual loss on this class of equipment.

Kitchen utensils are to be similarly treated.

The straight line method is recommended to be used throughout.

Improvements are to be capitalized and written off over their estimated life, which in no case shall be longer than that of the hotel property.

All ordinary repairs are to be charged direct to expense as they occur. The distribution of this expense, proportionately throughout the year, will be by means of a reserve for repairs, or repairs budget.

Small items of replacement are to be charged direct to expense with the repair items. Major purchases, in cases where original cost of article to be replaced is not obtainable, are to be charged in total to a capital account and depreciated over their estimated life.

These rates, and the procedure to be used with them, we believe to be fair and just, and heartily endorse them for your adoption.

PART II

HOTEL DEPRECIATION STUDIES

BY

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PART II

HOTEL DEPRECIATION STUDIES

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PAUL SIMON, of Horwath & Horwath

Introduction

FEDERAL Income Taxes are calculated on the basis of net profit, i. e., the balance left after all expenses of doing business are deducted from the revenue the business has produced.

A net profit, of course, is nonexistent if, during the life of a business, the original investment is not first returned to the investors.

The investment in hotels is practically entirely represented by items of long life, because the most important commodity sold is service. The investment in saleable merchandise is, therefore, relatively small. Further, because the great majority of transactions are on a cash or short term credit basis, even the accounts receivable are not an important burden to carry.

The total investment in medium sized hotels is averaged about as follows:

Land	20.00%
Building	60.00
Furniture, Fixtures and Equipment	11.00
Other Assets	9.00
Total	100.00%

In very large metropolitan hotels the relation of these assets to one another may be quite different for the reason that hotels now built on expensive land are a combination of other business enterprises in addition to the hotel proper.

II. Land

Land, of course, is not subject to depreciation. Indeed, if the hotel was originally well conceived and was erected on as good a site as it deserved, the land may be expected to appreciate in value.

It is true that there are isolated cases where the center of a town has moved and has left the hotel in an undesirable or inconvenient location. These cases are not only relatively rare but the actual loss from this cause, of course, cannot be anticipated. Consequently this loss will have to be taken when it occurs, and only then can it be considered for income tax purposes.

However, the increase of the value of land is not a pure advantage. Appreciation is logically followed by increased appraisals and assessments and quite often the improvement upon land—greatly increased in value —is not large or up-to-date enough to produce earnings in proportion to the increased value of the land as represented by increased Real Estate Taxes.

It follows that increased land value oftentimes accelerates the obsolescence of the building.

III. The Building

The depreciation rates now used average as follows:

Fireproof Buildings	2%-2½%
Semi-fireproof Buildings	2%-3%
Frame Buildings	3%-4%

It is to be kept in mind that, while following the general custom by expressing the depreciation rates as percentages, this usage is somewhat misleading under certain circumstances.

A depreciation rate of 2% represents an estimated life of fifty years, a rate of 4% represents twenty-five years, etc. It is reasonable to suppose that, if a hotel is purchased after 25 years and the original estimate of life is fifty years, the new owner has the right to write off his purchase price (for the building) over the remaining twenty-five years, which would be at the rate of 4%. We find that this common-sense procedure is often overlooked.

It is not to be doubted that it is the intent of the law that all legitimate business expenses be deducted before arriving at the net profit. Irrespective of the wording of the law it must be assumed that the taxpayer is permitted to write off during the life of the asset the original cost of acquiring it.

We find no fault with the allowances granted for "depreciation" as represented in the "physical" exhaustion of the building. Indeed, it would be difficult to prove that the type of fireproof hotel building now erected might not stand for a hundred years, so that on the basis of "physical life," a depreciation of one percent should be sufficient, if all repairs and replacements were charged off as expenses, when made.

However, not only in fireproof hotels but also in semi-fireproof and frame hotels the useful economic, i. e., the profitable life is considerably shorter than the physical life of the building.

All Federal Income Tax laws since the Revenue act of 1918 contain the following provision in enumerating the deductible business expenses:

"A reasonable allowance for exhaustion, wear and tear of property used in trade or business, including a reasonable allowance for obsolescence."

The regulations under the revenue acts of 1924 and 1926 include as article 166 the following paragraph:

"With respect to physical property the whole or any part of which is clearly shown by the taxpayer as being affected by economic conditions that will result in its being abandoned at a future date prior to the end of its normal useful life, so that depreciation deductions alone are insufficient to return the cost (or other basis) at the end of its economic term of usefulness, a reasonable deduction for obsolescence, in addition to depreciation may be allowed in accordance with the facts obtaining with respect to each item of property concerning which a claim for obsolescence is made. No deduction for obsolescence will be permitted merely because, in the opinion of the taxpayer, the property may become obsolete at some later date. This allowance will be confined to such portion of the property in which obsolescence is definitely shown to be sustained and cannot

TABLE NO. 1

State	Cities Canvassed	Cities Replied	Hotels Reported in 1900	Voluntarily Gone Out of Existence as Hotels To Date					Destroyed or Changed Between 1900 and 1928						In Existence in 1928 as in 1900
				Razed and Not Rebuilt as Hotel	Replaced by New Hotel	Now Rooming House	Now Apartments	Total	Remodeled	Enlarged by Addition	Destroyed by Fire		Combined with Other Hotel	Destroyed by Earthquake	
											Rebuilt	Not Rebuilt			
Alabama	5	4	14	7	1	1	.....	9	.....	.....	.....	.....	1	.....	4
Arizona	2	2	7	3	1	.....	.....	4	.....	.....	1	.....	.....	.....	2
Arkansas	7	6	26	9	3	1	.....	13	2	.....	.....	1	.....	.....	10
California	32	17	92	39	.....	14	.....	53	4	5	6	.....	.....	3	21
Colorado	8	6	44	16	1	3	1	21	6	2	1	.....	.....	.....	14
Connecticut	16	7	42	25	1	.....	.....	26	2	2	.....	.....	.....	.....	12
Delaware	1	1	5	2	.....	.....	.....	2	.....	.....	.....	.....	.....	.....	3
District of Columbia	1	1	32	23	2	.....	.....	25	.....	.....	.....	.....	.....	.....	7
Georgia	13	6	27	13	1	1	.....	15	2	.....	1	.....	.....	.....	9
Idaho	1	1	4	1	.....	.....	.....	1	2	.....	.....	.....	.....	.....	1
Illinois	42	21	127	47	8	2	1	58	12	5	1	2	.....	.....	49
Indiana	30	19	80	30	7	4	1	42	17	3	3	1	.....	.....	14
Iowa	19	12	50	11	4	4	1	20	8	1	.....	2	1	.....	18
Kansas	21	10	36	22	3	3	1	29	2	1	1	2	.....	.....	1
Kentucky	9	4	20	9	.....	1	.....	10	3	3	.....	.....	.....	.....	4
Louisiana	6	1	3	1	.....	.....	.....	1	.....	.....	.....	.....	.....	.....	2
Maine	7	4	25	10	2	.....	4	16	4	1	.....	1	.....	.....	3
Maryland	6	4	9	3	.....	.....	.....	3	3	.....	.....	2	.....	.....	1
Massachusetts	27	14	57	22	2	7	1	32	3	9	3	1	1	.....	8
Michigan	28	16	74	36	11	3	.....	50	4	8	5	1	.....	.....	6
Minnesota	11	6	34	15	.....	1	.....	16	4	2	.....	.....	.....	.....	12
Mississippi	9	7	19	5	2	3	.....	10	6	.....	1	.....	.....	.....	2
Missouri	15	6	29	8	2	.....	.....	10	4	1	.....	.....	3	.....	11
Montana	6	2	15	10	.....	3	.....	13	.....	.....	.....	.....	.....	.....	2

TABLE NO. 1 (cont'd)

State	Cities Canvassed	Cities Replied	Hotels Reported in 1900	Voluntarily Gone Out of Existence as Hotels To Date					Destroyed or Changed Between 1900 and 1928						In Existence in 1928 as in 1900
				Razed and Not Rebuilt as Hotel	Replaced by New Hotel	Now Rooming House	Now Apartments	Total	Remodeled	Enlarged by Addition	Destroyed by Fire		Combined with Other Hotel	Destroyed by Earthquake	
											Rebuilt	Not Rebuilt			
Nebraska	7	3	27	13	.....	2	.....	15	2	.....	1	.....	.....	.....	9
New Hampshire	4	3	12	4	.....	3	.....	7	3	.....	.....	.....	.....	.....	2
New Mexico	1	1	3	1	.....	1	.....	2	.....	.....	.....	.....	.....	.....	1
North Carolina	16	4	18	1	1	.....	.....	2	1	.....	3	1	.....	.....	11
New Jersey	6	4	18	6	.....	1	.....	7	1	.....	.....	.....	.....	.....	10
New York	59	26	243	128	8	10	.....	146	21	3	4	4	1	.....	64
Ohio	44	16	100	41	10	4	.....	55	7	13	2	2	.....	.....	21
Oregon	5	2	16	4	.....	3	.....	7	1	.....	3	.....	.....	.....	5
Pennsylvania	46	22	136	58	4	14	4	80	13	7	2	.....	.....	.....	34
Rhode Island	3	1	2	.....	.....	2	.....	2	.....	.....	.....	.....	.....	.....	0
South Carolina	13	3	11	6	.....	2	.....	8	2	.....	.....	.....	.....	.....	1
South Dakota	4	4	13	5	2	2	.....	9	.....	.....	2	2	.....	.....	0
Utah	4	1	6	4	1	.....	.....	5	1	.....	.....	.....	.....	.....	0
Vermont	3	1	7	3	.....	.....	1	4	.....	1	.....	2	.....	.....	0
Tennessee	9	5	28	19	3	1	.....	23	.....	.....	1	.....	.....	.....	4
Texas	34	20	67	39	4	2	.....	45	6	5	5	.....	.....	.....	6
Virginia	11	6	19	11	1	.....	1	13	2	.....	3	1	.....	.....	0
Washington	9	6	22	15	.....	4	.....	19	2	1	.....	.....	.....	.....	0
Wisconsin	21	9	41	15	.....	1	.....	16	5	1	3	.....	.....	.....	16
Wyoming	2	1	3	1	.....	1	.....	2	.....	.....	.....	1	.....	.....	0
Total	623	315	1663	741	85	104	16	946	155	74	52	26	7	3	400

be held applicable to an entire property unless all portions thereof are affected by the conditions to which obsolescence is found to be due."

The above is one of the points with which this depreciation study had to concern itself. We believed it necessary to investigate whether it was possible to prove that the useful life of a hotel is so much shorter than the physical life of the building, and that relatively so very few hotels are in existence more than twenty-five to thirty years, not on account of specific happenings, but because ordinary progress is causing an obsolescence so general in this industry, that it must be accepted as the rule, which rule is further proved by the very rare exceptions.

Six thousand questionnaires were sent out by Mr. E. C. Eppley as the chairman of the Committee on Depreciation and 595 answers were received.

Another 1,020 letters were sent out by Horwath and Horwath, which resulted in 441 replies, giving information concerning 1,663 hotels.

Then compilations were made from the Hotel Red Book of the year 1900, and the hotels listed in towns and cities of 10,000 or more inhabitants, were compared with those listed in the official Hotel Red Book of the year 1928, to establish how many of the hotels listed in 1900 were still listed this year. Careful attention was given to change of names, which is frequent, in order to be sure that no overstatement was made.

In Table No. 1 is presented the result of a canvass of 623 cities throughout 44 states of the union. From these 623 cities, data concerning 1,663 hotels in 315 cities were received. The summary indicates that 946, or 57% of the hotels reported as doing business in 1900, have ceased to exist as hotels in 1928. In some instances the building still stands although used for other than hotel purposes. However, in most cases the building was completely demolished, either because of condemnation or to make way for other improvements. Seven hundred and forty-one hotels came under this category. Eighty-five hotels have been completely torn down and replaced by another hotel. One hundred and four were converted into rooming houses which is evidence of the fact that new projects have compelled them to abandon the pretence of operating as hotels and forced them to secure revenue enough to exist by catering to a "rooming house" class of trade. Others, 16 in number, were converted into "apartments." In addition to the 946 which have gone out of existence as hotels there were 52 destroyed by fire and not rebuilt and 3 destroyed by earthquake and not rebuilt. Twenty-six destroyed by fire were rebuilt.

Furthermore, the summary shows one hundred fifty-five hotels in which major remodeling was done. By that is meant the complete rebuilding of the interior, the installation of bath rooms where none existed previously, changing of the lobby, addition of ball room and dining facilities and such other major improvements which would not ordinarily be made during the natural life of the building.

There were also 74 hotels to which additions were built and it is logical to assume that the original structure was considerably improved at the same time. In a few cases the additions have been built with a view to tearing the original structure down, as many hotel companies

desiring to replace their structure do not wish to go out of business during the course of construction.

Seven hotels were reported as combining with other similar projects.

Consequently, we have a total of 1,263 hotels which have either ceased to exist entirely or have undergone considerable change. That leaves 400 hotels, or 24%, which remain as they were in 1900.

It was found to be difficult to establish the exact length of life of old hotels which have gone out of existence, but with the assistance of local hotel associations, chambers of commerce, newspapers and trade papers we succeeded in obtaining what we believe to be accurate information regarding the useful life of 183 hotels in various parts of the country and widely divergent in size, type and character. (Special credit is due to Mr. John Willy, publisher of the "Hotel Monthly," who has assisted us in a very generous manner.)

No selection has been made, but all hotels where definite information was received are listed in the tabulation following:

It will be noted that the shortest life was 4 years, the longest life 108 years.

Table No. 2

State	City	Name of Hotel	Years in Existence
Alabama:			
	Enterprise	Enterprise	20
Arizona:			
	Tuscon	Belmont House	4
	Tuscon	San Augustin	15
California:			
	Los Angeles	Baltimore	11
	Los Angeles	Abbotsford Inn	27
	Los Angeles	Bellevue Terrace	36
	Los Angeles	California	16
	Los Angeles	Columbia	7
	Los Angeles	Hamilton	7
	Los Angeles	De Grenable	33
	Los Angeles	Jackson	13
	Los Angeles	Los Angeles	5
	Los Angeles	Mount Pleasant	12
	Los Angeles	Brunswick	18
	Los Angeles	Grand Pacific	11
	Los Angeles	Lincoln	36
	Los Angeles	Catalina	16
	Los Angeles	Lillie	11
	Los Angeles	Alcazar	9
	Los Angeles	Southland	24
	Los Angeles	Alhambra	28
	Elsinore	Amsbury	25
	Bakersville	Southern	30
	Pomona	Kellers	15
	Santa Rosa	Napoleon House	30

State	City	Name of Hotel	Years in Existence
California:	Fresno	Grand Central	42
	Fresno	Hughes	40
Colorado:			
	Colorado Springs	La Veta	40
Delaware:			
	Wilmington	Central	4
Florida:			
	Rockledge	Indian River	30
	Rockledge	Rockledge	30
	Rockledge	Plaza	30
	Daytona Beach	Halifax	40
Georgia:			
	Moultrie	Colquitt	30
Illinois:			
	Alton	Madison	32
	Rockford	Chick	42
	Chicago	Chicago Beach (#)	32
	Chicago	Palmer House	52
	Chicago	Lombard	6
	Chicago	Briggs	50
	Chicago	Wellington	50
	Chicago	Windsor-Clifton	40
	Chicago	Old Brevoort (#)	40
	Chicago	Stratford	40
	Chicago	Richelieu	10
	Chicago	Tremont	35
	Chicago	Grand Pacific	30
	Chicago	Gault	30
	Chicago	Victoria	20
	Chicago	Burkes European	20
	Chicago	Continental	20
	Chicago	Demings European	20
	Chicago	Oxford	20
	Champaign	Beardsley	32
Indiana:			
	Elkhart	Columbia	10
	Huntington	Grand View	40
	Huntington	Karlton	40
	Marion	Burrier House	31
	Marion	Oyster Bay	25
	Terre Haute	European	28
	Evansville	St. George	34
	Anderson	Hillwell	29
	Kokomo	Francis (#)	14
	Kokomo	Francis	17
	Fort Wayne	Baltes	28
Iowa:			
	Clinton	Windsor	52
	Davenport	Downs	43
	Davenport	Kimball	43
	Mason City	Wheeler	40

State	City	Name of Hotel	Years in Existence
Kansas:			
	Coffeyville	Eldridge House	52
	Coffeyville	Tremont House	39
	Coffeyville	Willard	28
	Coffeyville	Southern	52
	Emporia	Fifth Avenue	46
	Emporia	Whitley	42
Maryland:			
	Baltimore	Caswell (#)	24
	Hagerstown	Baldwin House	31
Massachusetts:			
	Attleboro	Briggs House	45
	Brockton	Fraser House	28
	Haverhill	Thorndyke	32
	Marblehead	Rock-Mere (#)	19
	Marblehead	Rock-Mere	8
Michigan:			
	Saginaw	Marshall House	32
	Saginaw	Everett House	64
	Saginaw	Vincent	28
	Saginaw	Sherman House	15
	Flint	Dibble House	21
	Flint	Sherman House	13
	Port Huron	Harrington	30
	Detroit	Tuller (#)	22
	Detroit	Ponchartrain	12
	Detroit	Cadillac (#)	32
	St. Clair	Oakland	25
	St. Clair	Somerville Springs	21
	Marquette	Janzen (#)	30
	Munising	Alger	31
Minnesota			
	Minneapolis	West	28
	Minneapolis	Nicollet (#)	65
	St. Paul	Sherman	20
	St. Paul	Metropolitan	35
	St. Paul	Merchants	50
	St. Paul	Windsor	35
Mississippi:			
	Jackson	Edwards	25
Missouri:			
	St. Louis	Planters	28
Montana:			
	Butte	Finlen	35
Nebraska:			
	Norfolk	Pacific	3
New Hampshire:			
	Concord	Eagle	38
New Jersey:			
	Asbury Park	Hoffman	35

State	City	Name of Hotel	Years in Existence
New York:			
	New York City	Knickerbocker	20
	New York City	Lorraine	28
	New York City	Savoy	30
	New York City	Balmoral	18
	New York City	Morton House	69
	New York City	Gilsey House	42
	New York City	St. Denis	67
	New York City	Cambridge	30
	New York City	Holland House	29
	New York City	Louis Sherry	20
	New York City	Manhattan	25
	New York City	Park Avenue	31
	New York City	Old Plaza	21
	New York City	Belvedere	44
	New York City	Astor House	81
	New York City	Buckingham	48
	New York City	Navarre	25
	New York City	Netherland	32
	New York City	Normandie	30
	New York City	Victoria	31
	New York City	Empire	28
	Amsterdam	Central	35
	Amsterdam	Imperial	42
	Corning	Dickinson House	50
	Troy	Wolf	41
	Troy	Morrison House	100
	Troy	Revere House	70
	Troy	Grand Union	65
	Buffalo	Iroquois	43
	Saratoga Springs	Everett	39
North Carolina:			
	Durham	Carrolina	14
	Durham	Corcoran	10
	Greensboro	Benbow House	50
	Greensboro	Cleggs	30
	Greensboro	Benton	10
	Raleigh	Carrolton	10
	Raleigh	Yarboro House	76
	Raleigh	Wrights	16
	Winston-Salem	Jones	20
	Winston-Salem	Phoenix	33
	Winston-Salem	Webster	15
Ohio:			
	Cincinnati	Burnet	50
	Cincinnati	Gerdes	35
	Columbus	Hartman	23
	Ashtabula	James	37
	Toledo	Boody House	51
	South Charleston	Houston Inn	13

State	City	Name of Hotel	Years in Existence
Pennsylvania:			
	Altoona	Logan House	77
	Philadelphia	Bingham	108
	Philadelphia	Continental	62
	Bloomsburg	St. Elmo	34
	Erie	Liebel House	32
	Erie	Morton House	77
	Erie	Union Depot	51
	Erie	Wilcox House	40
	Wernersville	Grand View	40
	Reading	Brighter	20
South Dakota:			
	Mitchell	Raymond House	40
Tennessee:			
	Chattanooga	Point	5
	Chattanooga	Southern	20
	Paris	New Carter House	43
Texas:			
	Beeville	The Little Inn	25
	Corsicana	Main	25
	Forth Worth	Mansion	30
Virginia:			
	Richmond	Jefferson (#)	33
Washington:			
	Olympia	Huggins	68
	Tacoma	Donnelly	40
	Tacoma	Tourist	43
Wisconsin:			
	Stevens Point	Jacobs House	46
	Stevens Point	Curran House	45
	Stevens Point	Grand Central	15
	Milwaukee	Pfister (#)	35
	Madison	Fess (#)	15

(#) Denotes Rebuilt

The average life of the hotels listed in Table No. 2 was 32.1 years and we believe that this constitutes a fair average for all hotels in the United States and Canada.

In this connection we quote from the book "Hotel Administration" by D. J. O'Brien & Charles B. Couchman, " . . . the usefulness of a building from a hotel standpoint may cover a comparatively short portion of the physical life of the building. The truth of this may readily be observed by reviewing the history of hotels in any large city. It is usually true in any city that the newest hotel has great advantages and may command a most profitable portion of the trade. But as soon as another new hotel of quality is built the previous one drops to secondary place and is no longer able to command the room revenue that it formerly did . . ."

Table 3 presents, in the first column the ratio of the cost of various units, to the total cost of an average fireproof hotel of modern construction. (H. L. Stevens & Company of New York and Chicago, Hotel Architects, have been co-operating by giving us information pertaining to a number of recently built hotels). The second column contains fair depreciation rates for the individual groups.

The method of arriving at the composite rate is explained in section IV under the heading "Unit and Composite Rates."

Following this method we arrive at a life of Thirty and One-Third years, which is slightly shorter than the figure shown as the average of Table II.

Table No. 3

	Ratio of Unit Cost to Total Cost	Estimated Life in Years	Depreciation Unit Rate	Depreciation Percentage Total Cost
Building Proper Including Foundation	58.46	50	2.00	1.169
Boilers	1.3	20	5.00	.065
Engines and Generators	2.5	24	4.17	.104
Ventilating	.71	15	6.67	.047
Refrigeration System	.88	15	6.67	.058
Elevator	3.8	15	6.67	.253
Plumbing and Heating	16.1	17	5.88	.947
Electrical Work	3.8	26	3.85	.146
Interior Trim, etc	8.5	20	5.00	.425
Tiling and Marble	3.95	50	2.00	.079
	100.00%			3.293%

The matter of obsolescence does not affect semi-fireproof and frame buildings any more than fireproof buildings. Therefore, depreciation rates heretofore accepted which may be in addition to the 3⅓% mentioned below will not be disturbed by the reasoning and findings in this investigation of conditions. Consequently the following rates are recommended:

Fireproof and semi-fireproof 3⅓%

Frame Buildings ..... 3⅓ to 4%

Inasmuch as the government will permit a variation of 20% in either direction, a rate of from about 2½% to 4% would be accepted for fireproof hotels without proof, other than a statement of reasons on the part of the taxpayer.

IV. Unit and Composite Rates

The government gives a choice in the manner of computing depreciation:

1—The unit method, by which separate accounts are kept by the various classes of items in accordance with the expectancy of life in each case.

2—The composite rate method, by which the ratio of the various items to the total is calculated and a composite fair rate is established.

The first method involves a considerable amount of bookkeeping and is probably somewhat too complicated for small and medium sized hotels. It also cannot be used in cases where a going hotel has been purchased, for in such cases it is seldom possible to find the detailed cost of the original equipment, and, even when found, this is difficult

to reconcile with the purchase price which may be considerably above or below the original cost, less depreciation.

The unit method lends itself particularly to the depreciation of Furniture, Fixtures and Equipment, as outlined in the following section.

V. Furniture, Fixtures and Equipment

While obsolescence also plays an important part in the decreasing value of these assets it does not so exclusively determine their length of life as in the case of the building.

It must be recognized, of course, that especially the high class transient and even more so the residential hotel, is forced not only to keep abreast but in fact to be the leader of the procession of changing styles. There is no doubt, that general prosperity and the subsequent habit of better and more luxurious living increases the demand for better things and thus accelerates obsolescence.

However, the items most strongly affected by obsolescence happen to be also those whose physical life is relatively short, so that a total composite rate as suggested should be fair.

The method of calculating the composite rate for hotel furnishings is shown in the following tables (4, 5 and 6).

Table No. 4

	Average Percentage of Group to Total Investment
Guest Room Furniture	21.37%
Springs, Mattresses and Pillows	6.84
Blankets	1.73
Lobby Furniture	3.98
Portable Lighting Fixtures	1.59
Carpets and Rugs	18.81
Curtains, Draperies and Scarfs	6.17
Dining Room Furniture	4.23
Kitchen Machinery and Equipment	10.56
Refrigeration System	6.17
Soda Fountain	.88
Office Furniture	1.61
Office Machinery	2.05
Barber Shop Equipment	.70
Laundry Machinery	5.92
Window Shades and Screens	1.39
Sundry Equipment	6.00
	100.00%

The preceding table is the average of fourteen recently built hotels, varying in size from 200 to 600 rooms. In old hotels, unfortunately, equipment accounts have not been separated generally, but we believe this table is sufficiently near general averages for practical purposes.

The rates of depreciation suggested in the answers received from 595 hotels in reply to the questionnaires varied considerably. Undoubtedly in some cases local conditions had a bearing on the estimate of the length of life. In other instances again the opinion was based on misunderstanding of the problem of depreciation.

In general, however, we found a very intelligent appreciation of the problem involved, notwithstanding the widely divergent conclusions reached.

In Table No. 5 is presented the highest, the lowest, the average and the suggested depreciation rates in percentage form and also the average life as suggested, expressed in terms of years:

Table No. 5

Group	Highest Opinion	Lowest Opinion	Average	Suggested	In Terms of Years
Guest Room Furniture	25%	5%	8.29%	8.33%	12
Springs, Mattress and Pillows	30	4	11.19	11.11	9
Blankets	40	4	15.49	16.67	6
Lobby Furniture	25	4	11.53	12.50	8
Portable Lighting Fixtures	25	3½	13.37	12.50	8
Carpets and Rugs	35	5	15.96	16.67	6
Curtains, Draperies and Scarfs	50	5	18.45	20.00	5
Dining Room Furniture	15	4	8.27	8.33	12
Kitchen Machinery and Equipment	25	4	10.02	10.00	10
Refrigeration System	20	5	9.00	9.09	11
Office Furniture	15	5	7.18	7.14	14
Office Machinery	20	5	12.56	16.67	6
Laundry Machinery	20	5	10.20	10.00	10
Window Shades and Screens	50	5	17.91	20.00	5
Sundry Equipment	25	5	10.81	10 00	10

Where the equipment accounts are kept in sufficient detail it is probably advisable to charge depreciation in the above manner (unit rates).

However, as especially in older hotels and in cases where a going concern is purchased, difficulties will be experienced in arriving at a detailed distribution of assets, and in other cases for the sake of greater simplicity, the "composite rate" method will be preferable.

The composite rate is arrived at by multiplying the depreciation rate by the ratio which the unit bears to the total investment as follows:

Table No. 6

	Ratio of Unit Cost to Total Cost	Unit Rate	Percentage Total Cost
Guest Room Furniture	21.55%	8.33%	1.795%
Springs, Mattresses. Pillows	6.95	11.11	.782
Blankets	1.85	16.67	.308
Lobby Furniture	4.10	12.50	.513
Portable Lighting Fixtures	1.75	12.50	.219
Carpets and Rugs	18.95	16.67	3.159
Curtains, Draperies, Scarfs	6.25	20.00	1.250
Dining Room Furniture	4.35	8.33	.362
Kitchen Machinery and Equipment	10.75	10.00	1.075
Refrigeration System	6.20	9.09	.558
Office Furniture	1.65	7.14	.116
Office Machinery	2.05	16.67	.342
Laundry Machinery	5.95	10.00	.595
Window Shades and Screens	1.40	20.00	.280
Sundry Equipment	6.25	10.00	.625
	100.00%		11.979%

Accordingly we believe that the average useful life of Hotel Furniture, Fixtures and Equipment is approximately 8⅓ years and that an average standard composite rate would be 12%.

It is understood, of course, that, while the above is a fair average, circumstances will alter cases and wherever possible each hotel should establish the ratio of the individual units to the total.

If this rate is accepted by the government, it will mean that any taxpayer using the accepted rates will not be required to furnish additional proof; in fact this will hold true in case of a variation of one-fifth in either direction. Consequently a rate on these assets from about 9½% to 14½% would be accepted without further verification, "than the statement of general conditions, which, in the opinion of the taxpayer, result in a deterioration of his assets greater or smaller than the average rate of deterioration in his industry."

Of course, the department will not refuse the acceptance of any reasonable rate irrespective of the standard agreed to, but in exceptional cases it would be the taxpayer's burden to prove the exception.

VI. China, Glass, Silver and Linen

The amount of depreciation on these commodities has little relation to the original investment therein. One of two hotels of the same size and with approximately the same volume of business may purchase twice the quantity of the other and may have one-half of its equipment unused in reserve.

Indeed the depreciation depends practically entirely on the frequency of use. Therefore, depreciation should be taken only on the supplies in use, which in the book on "Hotel Accounting" by Horwath & Toth is recommended as follows:

Table No. 7

Equipment in use — Average depreciated value — % of cost.

At End of—	China	Glassware	Silver	Linen
1st year	95%	100%	90%	83⅓%
2nd year	90	100	80	66⅔
3rd year	85	100	70	50
4th year	80	100	60	50
5th year and thereafter	75	100	50	50

During the fiscal year a reserve account is carried for each class of equipment included in this group. The estimated depreciation and loss is credited to the reserve and replacements are charged to the same reserve. The monthly charges to operation are based upon previous experience, expressed in percentages of the sales. The following "replacement rates", including provision for depreciation, loss and breakage, are based on the experience of eight representative hotels ranging in size from 200 to 1,000 rooms and in age from 2 to 40 years:

Table No. 8

"Depreciation Loss—Breakage—For Each $100.00 Net Sales"

	Minimum	Maximum	Average
Based on Room Sales:			
Rooms—China and Glass	$0.03	$0.25	$0.15
Linen	1.20	1.77	1.40
Based on Food Sales:			
Restaurant—China and Glass	1.00	2.70	1.92
Linen	.56	1.26	1.07
Silverware	.73	.89	.79

All the above is quoted from the previously mentioned book on hotel accounting.

Additional investigation of twenty-one hotels of various sizes and character have confirmed the stated averages as fair.

VII. Kitchen Utensils

It is recommended on the basis of experience to write down the original cost to the depreciated value in the following manner.

Table No. 9

"Depreciated Value—Kitchen Utensils"

At the end of:

First Year	85%
Second Year	70
Third Year	65
Fourth and Thereafter	50

All repairs and replacements to be charged off as current expenses.

VIII. Accounting for Depreciation

The Treasury Department has no objection to the use of any of the generally accepted methods of charging depreciation. Whatever method is used, three cardinal principles must be kept in mind:

First: The total charges for depreciation must not exceed the total of the investment in the depreciable assets.

Second: Once adopted, the method and rate of depreciation cannot be changed without specific permission obtained from the Department.

Third: An allowance for depreciation and obsolescence must be charged off by the taxpayer on his books and records in order to constitute an allowable deduction (see Bulletin F).

As long as the asset is charged off over the period of the life of the asset, this may be done;

A—In equal yearly amounts

B—In increasing amounts

C—In decreasing amounts.

There are certain good arguments in favor of any of these methods.

We quote from a letter of Mr. E. C. Green of the Statler in Buffalo, the following sound reasoning:

> "It is believed that in general the new or newer hotels have the advantage in patronage and that the only satisfactory depreciation schedule is to write off a larger percentage during the first years

of a hotel's existence in order that when the hotel is old the capital investment will have reduced to such a point that is possible for the hotel to continue in business, it being possible then to make the property profitable by charging low rates and thus attracting a certain class of patronage because the capital having been largely written off it will not require much of the profits to make it a satisfactory continuing investment. Therefore, we believe that if it would be possible to establish varying rates of depreciation this would be the most satisfactory and most reasonable solution. For example, if the Federal Tax authorities would permit, say, 6% to be written off each year for the first five years, and 5% for the second five years, and 4% for the third five years and 3% for the fourth five years, at the end of twenty years 90% of the capital would have been written off and it certainly would then be possible in most cases for a hotel to continue in existence for a longer period of years than twenty."

In principle, Mr. Green recommends method C, the decreasing amount method. A somewhat similar method is being used by taxpayers and accepted by the government, known as the "reducing balance method." After arriving at the estimated life of an asset, the rate is calculated, which, applied to the diminishing value of the asset, depreciates it to its estimated scrap value by the end of its useful life. An example is given in Table No. 10:

Table No. 10

Original Value of Asset — $100,000.00

	Balance at Beginning of Year	Rate	Amount of Depreciation
1st year	$100,000.00	13.026	$ 13,026.00
2nd year	86,974.00	13.026	11,329.23
3rd year	75,644.77	13.026	9,853.48
4th year	65,791.29	13.026	8,569.97
5th year	57,221.32	13.026	7,453.64
14th year	16,304.05	13.026	2,123.76
15th year	14,180.29	13.026	1,847.12
16th year	12,333.17	13.026	1,606.51
17th year	10,726.66	13.026	1,397.25
18th year	9,329.41	13.026	1,215.24
29th year	2,009.77	13.026	261.79
30th year	1,747.98	13.026	227.68
31st year	1,520.30	13.026	198.03
32nd year	1,322.27	13.026	172.23
33rd year	1,150.04	13.026	149.80
34th year	1,000.24	13.026	.....

The objection to this method is the fact that the highest amounts are written off for depreciation in those initial years, when on account of the greatest interest payments on bonded indebtedness the chances for profits and dividend payments are already very slim.

That very fact indeed is an equally sound argument for the advocates of the reversed method namely, the "increasing amounts" method, who claim that the higher amount of depreciation is more equitable at a later time. This method also is acceptable to the government, if properly applied.

In the hotel industry, however, the method of charging depreciation in "equal yearly amounts" is so well established and, furthermore,

has the advantage of so much greater simplicity that adherence to it is recommended.

The annual depreciation under this so-called "straight line" method is calculated by dividing the total cost of the asset by the number of years of its expected useful life.

As stated before, care should be taken not to apply erroneously percentages in lieu of terms of remaining life. For instance:

If the original cost of the hotel building is $1,000,000.00 and after ten years two additional floors are built at a cost of $100,000.00 and if the original estimate of life was 33⅓ years, the expectation for the life of the addition cannot exceed 23⅓ years.

Therefore, the annual depreciation would be calculated as follows:

Depreciation as charged heretofore—

3% on $1,000,000.00	$30,000.00
4.28% on $100,000.00	4,280.00
Total	$34,280.00

IX. Accounting for Maintenance, Repairs, Replacement and Improvements

It is obvious that all efforts of standardization of depreciation rates would be nullified, unless the principle of accounting for upkeep could also be established on a uniform basis.

This is a big subject in itself and cannot be fully covered in this limited space. Therefore, only a few cardinal principles are submitted in the following:

Improvements: as distinguished from repairs or replacements are mainly recognizable by the fact, that they will be reflected in creating increased earning capacity.

If an improvement stands this test, it should be capitalized and written off over the period of its estimated life, which, however, in no case can be longer than the remaining life of the hotel property.

Repairs and Maintenance: All ordinary repairs, most of which occur with more or less regularity annually, are to be written off when made. During the fiscal year the cost of repairs and maintenance may be equitably distributed by charging to operations each month the same amount, or an amount proportionate to the sales, and crediting a reserve account. The actual cost of repairs and maintenance is then charged to this reserve account, any remaining balance at the end of the fiscal year being closed out to profit and loss. This equalization of the monthly repair and maintenance charges is logical, because major repairs are usually made while business is slack, though the damage has been greater during the good business period.

Experience has shown that the expense of upkeep in hotels equals an amount from $60.00 to $90.00 per room per year.

Replacements: For practical purposes it is recommended to charge small items directly to expense, whereas major purchases should be charged to a capital account.

Where the original cost of the item replaced can be ascertained, this amount should be credited to the asset account, the depreciation so far taken should be debited to the reserve account, and the difference, if any, after considering salvage value, would result in a profit or loss to be taken at the time of replacement.